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Financial Markets

Irving Trust

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(Noon)

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M1 is growing too fast, faster than Chairman Volcker would like, so he's going to keep an eye on it. It's growing faster than I would like, so I'm going to keep an eye on it, and on the Fed. For nearly three-quarters of a year, M1 has been growing steadily at a 15% annual rate. This is nearly three times the maximum rate M1 was supposed to be allowed to grow in 1982. The Fed is nowhere close to its target for M1 at this time; a target based well above the top of last year's goal with a generous allowance for further expansion. Shifts into the new Super NOW accounts, around only since early January of this year, offer an inadequate explanation for why M1 has grown with such vigor since September of last year. Yet I maintain that the Fed is not yet tightening and that current Fed policy is "correct." Why?

The Fed currently is confronted with a very difficult policy decision because of persisting exceptionally strong demands for M1 balances on the part of the public. Money supply growth has continued strong because the Fed has accommodated these demands. However, interest rates are high enough to put some distance between the Fed and accusations that it has been freely pumping out the money. In this regard, the recent higher trading range for Fed funds is an indication that the Fed is concerned about fast growing M1. But the Fed cannot do much more with interest rates; the economy is too weak. Raising interest rates (by draining bank reserves) would require an excessively sharp increase in rates if that move were intended to force M1 back inside its target range soon. Such an action would return M1 to its target range by deepening the recession rather than by encouraging people to hold fewer M1 balances through interest rate incentives. At this time, in fact, interest rates have a very small scope to rise. If domestic CD rates move much above 9%, certainly at the 9½% level, banks would be forced to raise their prime rates. Such an action would have a profound impact on market sentiment. As a result, the Fed funds rate is currently being held hostage between the discount rate at 8½% and a ceiling of about 9%.

M1 velocity usually picks up as GNP growth speeds; thus, as recovery develops, the Fed should gain scope to move M1 back toward its target range without pushing up rates. But right now, M1 velocity is a problem. Based on the Commerce Department's "flash" GNP estimate, M1's velocity shifted downward by about 7% in the first quarter of this year, continuing the recent bizarre behavior of money demand. The first-quarter decline in interest rates naturally contributes to this stronger demand for M1 balances (slower velocity). Also, the tendency for merchandisers to provide discounts for cash and for noncredit card purchases may increase the public's demand for M1 balances, especially in a low interest rate environment. Still, velocity should become somewhat more normal as this recovery unfolds.

The Fed can tolerate fast growing money for a while longer. As long as the Fed can be trusted to rein this growth in when velocity shifts back, there is no need for the public to fear inflationary effects. But Chairman Volcker does seem nervous about the fast growth. Looking ahead, with his term set to expire in August, he may not want to leave a legacy of fast money growth in the event that he should leave the chairmanship. But any move to tighten is still in the future.

Robert A. Brusca

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Market Yields

	3/25/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.63	8.63	14.25
Repurchase Agreements	8.63	8.63	13.50
U.S. Treasury Issues			
Bills			
3 months	8.82	8.70	13.45
6 months	9.09	8.94	13.94
1 year	9.23	9.18	14.06
Coupons			
2 years	9.85	9.75	14.25
4 years	10.20	10.03	14.15
7 years	10.52	10.44	14.02
10 years	10.57	10.56	13.90
Long Bond	10.61	10.68	13.51
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.85	8.70	14.15
3 months	9.00	8.80	14.40
6 months	9.15	9.00	14.50
1 year	9.45	9.20	14.60
Banker's Acceptances			
1 month	8.85	8.70	14.05
3 months	9.00	8.80	14.35
6 months	9.20	9.05	14.50
Eurodollar Deposits			
1 month	9.38	9.19	15.00
2 months	9.44	9.25	15.13
3 months	9.50	9.38	15.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.76	8.51	13.72
1 month	8.94	8.82	13.85
3 months	9.07	8.81	13.63
Bank Holding Companies			
1 month	8.56	8.30	13.72
Dealer Placed:			
3 months	8.98	8.80	14.44
New AA Corporate Utility Bond	12.10	11.95	16.13
Tax Exempt			
6 month Project Notes	4.70	4.60	8.20
1 year AAA Bond	4.85	5.10	8.10
5 year AAA Bond	6.40	6.00	9.50
20 year AAA Bond	8.75	8.50	12.00

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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